

DOUGLAS COUNTY RURAL WATER DISTRICT NO. 2
Lawrence, Kansas

STATUTORY BASIS FINANCIAL STATEMENTS
For the year ended December 31, 2011

And

INDEPENDENT AUDITORS' REPORT

Long CPA, PA
A Professional Association
Certified Public Accountants

DOUGLAS COUNTY RURAL WATER DISTRICT NO. 2
Lawrence, Kansas

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To the Board of Directors
Douglas County Rural Water District No. 2
Lawrence, Kansas 66046

INDEPENDENT AUDITORS' REPORT ON FINANCIAL STATEMENTS

We have audited the financial statements of the individual funds of Douglas County Rural Water District No. 2, Lawrence, Kansas, as of and for the year ended December 31, 2011, as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the Kansas Municipal Audit Guide. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

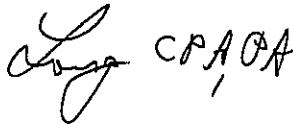
As described more fully in Note 1, the District has prepared these financial statements in conformity with the accounting practices prescribed by the State of Kansas to demonstrate compliance with the cash basis and budget laws of the State of Kansas, which practices differ from accounting principles generally accepted in the United States of America. The effect on the financial statements of the variances between these regulatory accounting practices and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

In our opinion, except for the item described in the preceding paragraph, the financial statements, referred to above, present fairly, in all material respects, the cash and unencumbered cash of Douglas County Rural Water District No. 2, as of December 31, 2011 and the revenues it received and expenditures it paid for the year then ended, on the basis of accounting described in Note 1.

Board of Directors
Douglas County Rural Water District No. 2

Our audit was made for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental information presented on pages 12-18 is presented for purposes of additional analysis and is not a required part of the basic financial statements of Douglas County Rural Water District No. 2, Lawrence, Kansas. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, subject to the above qualifications, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The supplemental schedules on pages 12 and 13 differ from the information presented in the basic financial statements, which are presented on a basis of accounting which demonstrates compliance with the cash basis and budget laws of Kansas.

A handwritten signature in cursive script, appearing to read "Long CPA, PA", with a small mark below the "A".

Long CPA, PA
A Professional Association
Certified Public Accountants

March 16, 2012

DOUGLAS COUNTY RURAL WATER DISTRICT NO.2
SUMMARY OF CASH RECEIPTS, EXPENDITURES AND UNENCUMBERED CASH
For the year ended December 31, 2011

Funds	Beginning Unencumbered Cash Balance	Prior Year Cancelled Encumbrances	Cash Receipts	Expenditures	Ending Unencumbered Cash Balance	Add	
						Outstanding Encumbrances and Accounts Payable	Ending Cash Balance
Proprietary Type Funds							
Water Utility	\$ 576,505	\$	\$ 522,703	\$ 654,480	\$ 444,728	\$ -	\$ 444,728
Total Reporting Entity	\$ 576,505	\$ 0	\$ 522,703	\$ 654,480	\$ 444,728	\$ 0	\$ 444,728
Composition of Cash							
					Checking Accounts	\$	247,689
					Savings Accounts		
					Petty Cash		
					Certificates of Deposit		197,039
					Total Reporting Entity	\$	444,728

The notes to the financial statements are an integral part of this statement.

DOUGLAS COUNTY RURAL WATER DISTRICT NO. 2
WATER UTILITY FUND

Statement of Cash Receipts and Expenditures - Actual and Budget
For the year ended December 31, 2011

	<u>Actual</u>
CASH RECEIPTS	
Charges for services	\$ 464,816
Line installation	41,225
Interest income	3,662
Benefit units	<u>13,000</u>
 Total Cash Receipts	 <u>522,703</u>
 EXPENDITURES	
Production	346,850
Capital outlay	79,280
Debt Service	228,350
Operating transfers	0
Adjustment for qualifying budget credits	<u>0</u>
 Total Expenditures	 <u>654,480</u>
 Receipts Over (Under) Expenditures	 (131,777)
Unencumbered Cash, Beginning	576,505
Prior Year Cancelled Encumbrances	<u>0</u>
 Unencumbered Cash, Ending	 \$ <u><u>444,728</u></u>

The notes to the financial statements are an integral part of this statement.

DOUGLAS COUNTY RURAL WATER DISTRICT NO.2

Lawrence, Kansas

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – Summary of Significant Accounting Policies

Financial Reporting Entity

The Douglas County Rural Water District No. 2 (RWD No. 2) (the District) is a water utility that provides service to 467 and 465 rural customers as of December 31, 2011 and 2010, respectively. The district was organized as a quasi-municipal corporation to acquire water and water rights and to build and acquire pipelines for the purpose of furnishing water to owners and occupants of land located within the District.

The following types of funds comprise the financial activities of the District for the year of 2011:

Proprietary Funds

Enterprise Funds - To account for operations that are financed and operated in a manner similar to private business enterprises – where the stated intent is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges – or where periodic determination of revenues earned, expenses incurred, and/or net income is deemed appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Statutory Basis of Accounting

The statutory basis of accounting, as used in the preparation of these statutory basis financial statements, is designed to demonstrate compliance with the cash basis and budget laws of the State of Kansas. Cash receipts are recognized when the cash balance of a fund is increased. Expenditures include disbursements, accounts payable and encumbrances. Encumbrances are commitments related to unperformed (executory) contracts for goods and services, and are usually evidenced by a purchase order or written contract. For an interfund transaction, a cash receipt is recorded in the fund receiving cash from another fund, and an expenditure would be charged in the fund from which the transfer is made.

The municipality has approved a resolution that is in compliance with K.S.A. 75-1120a(c), waiving the requirement for application of generally accepted accounting principles and allowing the municipality to use the statutory basis of accounting.

DOUGLAS COUNTY RURAL WATER DISTRICT NO.2

Lawrence, Kansas

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – Summary of Significant Accounting Policies (Continued)

Departure from Generally Accepted Accounting Principles (GAAP)

The basis of accounting described above results in a financial statement presentation which shows cash receipts, cash disbursement, cash and unencumbered cash balances, and expenditures compared to budget. Balance sheets that would have shown noncash assets such as receivables, inventories, and prepaid expenses, liabilities such as deferred revenues and matured principle and interest payable, and reservations of fund balance are not presented.

Under accounting principles generally accepted in the United States of America, encumbrances are only recognized as a reservation of fund balance; encumbrances outstanding at year-end do not constitute expenditures or liabilities. Consequently, the expenditures as reported do not present the cost of goods and services received during the fiscal year in accordance with United States generally accepted accounting principles. Capital assets that account for the land, buildings, and equipment owned by the District are not presented in the financial statements.

Inventories and Prepaid Expenses

Inventories and prepaid expenses which benefit future periods are recorded as expenditures.

Use of Estimates

The preparation of modified cash basis financial statements requires management to make estimates and assumptions that affect certain reported amounts and disclosures in the financial statements. Actual results could differ from those estimates.

Cash and Cash Equivalents

For purposes of the statement of cash flows and summary of cash balances, cash and cash equivalents are defined as demand deposits and certificates of deposit at banks with maturities of three months or less.

DOUGLAS COUNTY RURAL WATER DISTRICT NO.2

Lawrence, Kansas

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – Summary of Significant Accounting Policies (Continued)

Property and Equipment

Property and equipment are recorded at cost. Improvements and betterments to existing property and equipment are capitalized. Expenditures for maintenance and repairs which do not extend the life of the applicable assets are charged to expense as incurred. Depreciation is computed using the straight line method over an estimated useful life of 30 years. Depreciation and amortization expense totaled \$ 79,275 and \$ 80,086 for the years ended December 31, 2011 and 2010, respectively.

Memberships

The District adds the cost of purchasing a benefit unit directly to district equity rather than recognizing those sums as revenues.

Income Taxes

In prior years, it has been held that the District is exempt from income taxes under Section 115 of the Internal Revenue Code both because it is a public utility under Section 247 and because it is a political subdivision of the State of Kansas (K.S.A. 82a-601,et.seq.).

In a 1992 published Internal Revenue Service opinion, it was determined that Kansas rural water districts do not qualify as political subdivisions for the purposes of the exemption from payment of FUTA. No claim has been asserted against the District for this tax, nor is the amount of any such claim determinable at this time. Kansas law has been changed, effective March 20, 1992, the result of which causes rural water districts to again qualify as a political subdivision for the purpose of the exemption for payment of FUTA. We are unable to determine at this time whether or not a claim will ultimately be asserted against the District, the likelihood that it would ultimately be held liable for that claim, or the ultimate amount of that claim, if assessed. Consequently, no additional liabilities relating to a possible claim have been recognized.

DOUGLAS COUNTY RURAL WATER DISTRICT NO.2

Lawrence, Kansas

NOTES TO FINANCIAL STATEMENTS

NOTE 2 – Deposits and Investments

Deposits

K.S.A. 9-1401 establishes the depositories which may be used by the district. The statute requires banks eligible to hold the district's funds have a main or branch bank in the county in which the district is located and the banks provide an acceptable rate of return on funds. In addition, K.S.A. 9-1402 requires the banks to pledge securities for deposits in excess of FDIC coverage. The district has no other policies that would further limit interest rate risk.

K.S.A. 12-1675 limits the district's investments of idle funds to time deposits, open accounts, and certificates of deposit with allowable financial institutions; U.S. government securities; temporary notes; no-fund warrants; repurchase agreements; and the Kansas Municipal Investment Pool. The district has no investment policy that would further limit its investment choices.

Concentration of Credit Risk

State statutes place no limit on the amount the district may invest in any one issuer as long as the investments are adequately secured under K.S.A. 9-1402 and K.S.A. 9-1405.

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a bank failure, the district's deposits may not be returned to it. State statutes require the district's deposits in financial institutions to be entirely covered by federal depository insurance or by collateral held under a joint custody receipt issued by a bank within the State of Kansas, the Federal Reserve Bank of Kansas City, or the Federal Home Loan Bank of Topeka, except during designated "peak periods" when required coverage is 50%.

At December 31, 2011, the District's carrying amount of deposits, including certificates of deposit, was \$ 444,728 and the bank balance was \$ 453,461 of which \$ 447,039 was covered by FDIC insurance. All balances were collateralized with securities held by the pledging financial institutions' agents in the district's name.

DOUGLAS COUNTY RURAL WATER DISTRICT NO.2
Lawrence, Kansas

NOTES TO FINANCIAL STATEMENTS

NOTE 2 – Deposits and Investments (Continued)

Custodial Credit Risk – Investments

For an investment, this is the risk that, in the event of the failure of the issuer or counterparty, the district will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. State statutes require investments to be adequately secured.

NOTE 3 – Risk Management

The District is exposed to various risks of loss related to limited torts; theft of, damage to and destruction of assets; errors and omissions and natural disasters for which the county carries commercial insurance. There have been no significant reductions in coverage from prior years and settlements have not exceeded coverage in the past three years.

NOTE 4 – Compliance with Kansas Statutes

We noted no violations of Kansas statutes during the period under examination.

NOTE 5 – Kansas Water Resources Board Contract

The District entered into a water supply contract with the Kansas Water Resources Board to withdraw a predetermined amount of water from Clinton Reservoir each year. The allowed withdrawal is re-determined and the rate charge is set each year. A minimum of 42.5 million gallons must be paid for each year at the established price. Water is also purchased from the City of Lawrence.

NOTE 6 – Concentration of Credit Risk

The District currently has all of its certificates of deposit and demand deposits with three financial institutions in Lawrence, Kansas banks. This is a concentration of credit risk related to deposits.

DOUGLAS COUNTY RURAL WATER DISTRICT NO.2

Lawrence, Kansas

NOTES TO FINANCIAL STATEMENTS

NOTE 7 – Subsequent Events

Subsequent events for management's review have been evaluated through March 16, 2012. The date in the prior sentence is the date the financial statements were available to be issued.

NOTE 8 – Long Term Debt

The following are schedules of the long term debt and current maturities of debt of the District.

NOTE 8-

DOUGLAS COUNTY RURAL WATER DISTRICT NO.2

Changes in Long-Term Debt

For the year ended December 31, 2011

Issue	Interest Rates	Date of Issue	Amount of Issue	Date of Final Maturity	Balance Beginning of Year	Additions	Reductions/ Payments	Net Change	Balance End of Year	Interest Paid
State Reserve Fund Loan No. 2656	3.42%	6/1/10	\$ 563,021	8/1/30	\$ 563,021	\$	\$ 215,272	\$ (215,272)	\$ 347,749	\$ 16,146
Total Long Term Debt					\$ 563,021	\$ 0	\$ 215,272	\$ (215,272)	\$ 347,749	\$ 16,146
		2012	2013	2014	2015	2016	2017-2021	2022-2026	2027-2030	Total
Principal										
General Obligation Bonds	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Special Assessment Bonds										
Certificates of Participation										
Capital Leases										
Revenue Bonds										
SRF Loan	12,808	13,296	14,871	14,326	14,326	14,871	83,291	100,393	94,963	347,749
Temporary Notes										
Total Principal	12,808	13,296	14,871	14,326	14,326	14,871	83,291	100,393	94,963	347,749
Interest										
General Obligation Bonds										
Special Assessment Bonds										
Certificates of Participation										
Capital Leases										
Revenue Bonds										
SRF Loan	11,784	11,342	10,883	10,407	10,407	9,912	41,458	25,944	7,467	129,197
Temporary Notes										
Total Interest	11,784	11,342	10,883	10,407	10,407	9,912	41,458	25,944	7,467	129,197
Total Principal and Interest	\$ 24,592	\$ 24,638	\$ 24,684	\$ 24,733	\$ 24,733	\$ 24,783	\$ 124,749	\$ 126,337	\$ 102,430	\$ 476,946

DOUGLAS COUNTY RURAL WATER DISTRICT NO. 2

BALANCE SHEETS

As of December 31, 2011 and 2010

ASSETS		2011	2010
Current Assets			
Cash and cash equivalents	\$	247,689	\$ 384,545
Certificates of deposit		197,039	195,036
Accounts receivable		36,160	65,319
Prepaid expenses		61,767	19,412
Other receivables		6,989	1,024
Total current assets		549,644	665,336
Property, plant, and equipment, net		2,342,012	2,341,552
Other Assets			
SRF loan fees net accumulated amortization		8,559	9,013
SRF loan reserve		74,919	74,919
Total other assets		83,478	83,932
Total Assets	\$	<u>2,975,134</u>	\$ <u>3,090,820</u>
LIABILITIES AND DISTRICT EQUITY			
Current Liabilities			
Accounts payable	\$	28,319	\$ 3,076
Accrued interest payable		4,955	8,023
Customer deposit		1,000	
Payroll and sales taxes payable		2,290	2,335
Current portion of long term debt		12,808	19,292
Total current liabilities		49,372	32,726
Long Term Liabilities			
SRF loan, net of current portion long term debt		334,941	543,729
Total liabilities		384,313	576,455
District Equity		2,590,821	2,514,365
Total liabilities and member's equity	\$	<u>2,975,134</u>	\$ <u>3,090,820</u>

The notes to the financial statements are an integral part of this statement.

DOUGLAS COUNTY RURAL WATER DISTRICT NO. 2

STATEMENTS OF OPERATIONS

For the years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Revenues		
Water sales	\$ 435,658	\$ 362,035
New construction	41,225	57,520
Line repair reimbursement		149
Materials and supplies	57	304
Service review	391	400
Customer returns	(14)	(92)
	<u>477,317</u>	<u>420,316</u>
Expenses		
Water purchased	179,165	139,024
Salaries and wages	59,119	68,795
Contract labor	9,455	3,384
Repairs and maintenance	18,481	11,683
Utilities and telephone	11,622	11,283
Insurance and bonds	8,349	8,564
Office supplies	4,718	5,683
Professional and other services	10,074	9,304
Payroll taxes	5,162	5,263
Dues and fees	371	344
Depreciation	78,820	79,735
Amortization	455	351
Mileage and auto expense	6,358	6,259
Board expenses	748	459
Continuing education	540	1,392
Operating supplies	7,961	7,199
Rental expense	1,404	1,404
License and fees	289	804
Bank fees	1,354	302
Returned checks		229
	<u>404,445</u>	<u>361,461</u>
Net income from operations	<u>72,872</u>	<u>58,855</u>
Other Income (Expense)		
Miscellaneous income	1,566	2,708
Interest income	2,096	3,260
ARRA principal forgiveness		186,162
Interest expense	(13,078)	(16,243)
Loss on investment		(100,000)
Penalties		(79)
	<u>(9,416)</u>	<u>75,808</u>
Other Income/Expense, Net	<u>(9,416)</u>	<u>75,808</u>
Net Income	<u>\$ 63,456</u>	<u>\$ 134,663</u>

The notes to the financial statements are an integral part of this statement.

DOUGLAS COUNTY RURAL WATER DISTRICT NO. 2**STATEMENTS OF CHANGES IN DISTRICT EQUITY**

For the years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
District Equity - Beginning of year	\$ 2,514,365	\$ 2,366,702
Memberships	13,000	13,000
Net Income	<u>63,456</u>	<u>134,663</u>
District Equity - End of year	\$ <u><u>2,590,821</u></u>	\$ <u><u>2,514,365</u></u>

The notes to the financial statements are an integral part of this statement.

DOUGLAS COUNTY RURAL WATER DISTRICT NO. 2

STATEMENTS OF CASH FLOWS

For the years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash Flows from Operating Activities		
Net Income	\$ 63,456	\$ 134,663
Adjustments to Reconcile Net Income to Net Cash		
Provided by (Used in) Operating Activities		
Depreciation and amortization	79,275	80,086
(Increase) decrease in accounts receivable	29,159	(37,191)
(Increase) decrease in other receivables	(5,965)	40,796
(Increase) decrease in prepaid expenses	(42,356)	(1,324)
Increase (decrease) in accounts payable	25,243	(63,620)
Increase (decrease) in accrued interest	(3,068)	8,023
Increase (decrease) in customer deposit	1,000	
Increase (decrease) in taxes payable	(45)	65
Net Cash Provided By Operating Activities	<u>146,699</u>	<u>161,498</u>
Cash Flows from Investing Activities		
Proceeds from sale of benefit units	13,000	13,000
Proceeds from certificates of deposit	(2,003)	373,555
Loss on investments		100,000
Purchase of assets	(79,280)	(825,719)
Net Cash Provided By Investing Activities	<u>(68,283)</u>	<u>(339,164)</u>
Cash Flows from Financing Activities		
Principal payemnts on long term debt	(215,272)	
Loan proceeds		749,183
SRF loan fees		(9,365)
SRF loan reseve		(74,918)
ARRA principal forgiveness		(186,162)
Net Cash Provided By Financing Activities	<u>(215,272)</u>	<u>478,738</u>
Net Increase (Decrease) In Cash	(136,856)	301,072
Cash - Beginning of Period	<u>384,545</u>	<u>83,473</u>
Cash - End of Period	<u>\$ 247,689</u>	<u>\$ 384,545</u>

The notes to the financial statements are an integral part of this statement.

DOUGLAS COUNTY RURAL WATER DISTRICT NO. 2

SUMMARY OF INSURANCE COVERAGE AND FIDELITY BONDS

As of December 31, 2011

Property Covered	Coverage	Expires
Commercial property:	80% Coinsurance	10/6/2012
Radio and antenna	16,322	
Property in the open	16,208	
Building #2 (42'x50' metal shed)	54,009	
Property in the open	4,052	
Booster pumps	32,642	
Property in the open	10,130	
Elevated water tower	732,922	
Extra expense	90,000	
Personal property in office	14,000	
Commercial General Liability:		10/6/2012
Aggregate Limit -		
products/completed operations	1,000,000	
other than products/completed ops	1,000,000	
Personal and advertising injury	1,000,000	
Fire damage (per fire)	100,000	
Medical expense (per person)	5,000	
Inland marine		10/6/2012
Miscellaneous inventory	35,000	
Commercial Auto:		10/6/2012
Liability insurance (per loss)	1,000,000	
Workmen's compensation:		10/6/2012
Bodily injury by accident	500,000	
Bodily injury by disease (per employee)	500,000	
Bodily injury by disease (policy limit)	500,000	
Public Employee Dishonesty:		10/6/2012
Per loss	250,000	
Directors' and Officers' Liability:	1,000,000	10/6/2012

The notes to the financial statements are an integral part of this statement.

DOUGLAS COUNTY RURAL WATER DISTRICT NO. 2

SCHEDULE OF FIXED ASSETS ADDITIONS AND RETIREMENTS

As of December 31, 2011

	<u>2010</u>	<u>Additions</u>	<u>Deletions</u>	<u>2011</u>
Rural Water system	\$ 2,395,374	\$ 69,357	\$	\$ 2,464,731
Elevated water tower	720,205	9,923		730,128
Land	<u>19,500</u>			<u>19,500</u>
	3,135,079	79,280	-	3,214,359
Less Accumulated depreciation	<u>793,528</u>	<u>78,820</u>		<u>872,348</u>
Proj Water system	\$ <u>2,341,551</u>	\$ <u>460</u>	\$ <u>-</u>	\$ <u>2,342,011</u>

The notes to the financial statements are an integral part of this statement.

DOUGLAS COUNTY RURAL WATER DISTRICT NO. 2**BOARD MEMBERS AND OFFICERS**

As of December 31, 2011

		Term Expires
Chairman:	Arthur Miles 1278 N. 900 Road Lawrence, KS 66046	2013
Vice-Chairman:	Chip Hornberger 933 N. 500 Road Lawrence, KS 66006	2012
Secretary:	Rick Hird 856 E. 1150 Road Baldwin, KS 66006	2014
Treasurer:	Mike Flory 1921 Quail Run Lawrence, KS 66047	2013
Board Member:	John Stevens 795 E 1500 Road Lawrence, KS 66046	2012

The notes to the financial statements are an integral part of this statement.